



TAKING CONTROL of Claims Management WITH YOUR CAPTIVE

Written By Karrie Hyatt

When insuring through a traditional insurer, the insurance company bears the responsibility of how claims are managed. Not so when self-insuring through a captive. Owner/insureds must become involved with claims management and for most captives that is the key to whether or not it is successful. As claims can be the most variable and expensive cost for any insurance company, any substantial cost savings will come from the claims area. Captives require owners to substantially change how they think about claims.

“A captive insurance company exists for a single purpose: to manage the claims of its owner. There is no more important function in a captive than its claims-paying ability and the integrity of its claims-paying process,” said Michael Maglaras, principal with Michael Maglaras & Company.



The Benefits of Claims Management

Insuring through a commercial insurance company seems like it's uncomplicated, but there are a number of downsides when it comes to claims. Insurers can take months to evaluate and settle claims, the processing agent is not likely to be familiar with the details of the insureds' business, the insured has little or no say in how claims are settled, and insureds have to rely on attorneys working for the insurer when a claim is disputed.

Captive insurers upend these issues. The owner/insureds have the power to create their own procedures around claims adjustment and processing. They can choose when to pay a claim or when to deny it—individually assessing claims to the benefit of their company. They can also retain their own attorneys who will represent their interests.

“In deciding to setup a captive, the owner has made an affirmative statement that it wants to take control of risks and manage those risks,” said Lynn Sheils, general counsel with EWI Re, Inc. *“A captive owner has the ability to control how claims are handled and ensure that its organizational philosophies are guiding claims decision. The claims handlers at commercial insurers are never going to understand the complexities of its insured’s business the way its captive team will.”*

Claims can be resolved quickly and can help inform the parents as to where risk management needs to concentrate their efforts. “With a captive,” said Maglaras, “The immediacy of a claim reserve and its eventual adjustment have a tendency to ‘focus the mind’ of management. This results in a deeper dive into claim cause-of-loss and the impact that claims have on a business’s operations, bottom line, and reputation management. Business leaders pay attention when claim activity impacts, in a direct way, financial outcomes.”

By insuring risk through a captive, companies become more aware of where their premiums are going and how they are being used. According to Jeff Kenneson, president, Quest Captive Management (USA), “A captive’s profitability relies heavily on the claims activity since most other expenses are known or static going into the arrangement, the big variable is the claims experience. In the traditional market, the owner pays a premium with the assumption that the carrier will pay losses. There’s no real pressure to keep losses down from a financial perspective year by year; the premium money is gone.”

For many companies claims, and whether they are paid or challenged, can affect their reputations. By taking control of claims through their captive, a company has more control over its reputation. “Many companies, especially those in the consumer goods and services sectors, brand and reputation is crucial, so these companies may desire to settle claims quickly to prevent ill-will,” said Sheils.



“There are reasons why companies may want to challenge claims and drive a claim to litigation,” she continued. “Such as companies who find themselves frequently targeted who don’t want to set a precedent of being an easy target or companies facing a claim asserting a unique or novel theory may be worried about a piling on effect and choose to litigate. Traditional insurers may see this as being the more expensive strategy and instead choose to settle. Companies with a lot of litigation often have legal teams they prefer to work with but won’t be allowed to use the preferred lawyer because the lawyer is not on the insurer’s panel counsel list. With a captive, a company has the ability to set these claim handling priorities and take back control of claims.”

The Issues of Managing Claims

A primary concern for captives is that if it doesn’t have adequate capital to cover all claims that come up, the parent company is on the line to pay out of pocket. Kenneson said, “The hope is that the risk is properly underwritten so that there are sufficient funds in the captive to pay the losses and expenses with excess funds leftover, profit. If the captive is underfunded and can’t meet its obligations, there’s nobody to step in to support the captive except the owner.” While captive regulators keep a sharp eye on their captives’ funding levels, it always behooves a captive to keep on top of it themselves.

Another issue, according to Maglaras, is that captive owners sometimes make the mistake of being overconfident in their knowledge of insurance.

“Where we sometimes see captives perform less well than anticipated is when the management of a parent’s captive believes they already possess the skills needed to adjust their own losses,” he said. *“I advise captive owners, particularly in the early years*

of a captive’s life, to get good advice from a knowledgeable third-party administrator in key areas, such as litigation management, reserving, and adjustment. Once a captive is formed, a good TPA, who treats a captive’s assets as if they were their own, can be instrumental in a captive’s success.”

Conflicts of interest can arise when owners are involved in claims management. An owner may take exception to a claim being settled, even if it is in the best interest of the captive and its parent. Kenneson said, “There can be inherent conflicts of interest that need to be address when the owners are involving themselves with claims through the captive. The owner must ensure that

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pave the way for advance preparation of claims. The procedure will reinforce the claims handling philosophy of the captive's owner. The procedure will allow for smoother handling of claims by giving forethought to all aspects of claims handling, such as who will be the captive's vendors for services that arise in claims.... The procedure will also force consideration as to what type of claims information the captive is going capture to help risk management with understanding risks and managing them. A Claims Handling Procedure is a best practice for captives."

the captive doesn't run afoul of any unfair claims settlement practices act. There may be occasions when the owner doesn't want to pay a particular claim or fees the claim is frivolous. Captives can deny claims like any other insurance company.

However, care needs to be given in these circumstances to ensure the claim is denied properly."

Claims Management Advice for Owners

Claims management can seem to be a mundane necessity of a captive insurance company, but, Kenneson advises, "Don't take this function lightly. Paying attention to this function and being proactive to trends can be the difference between a failed captive and one in which management utilizes as an effective tool to move and adapt to

the expanding needs of a maturing parent company."

Claims are at the heart-of-the-matter in any insurance company but can be given little notice by captive owners in favor of more dynamic topics like investment portfolios and regulatory changes. Yet, the whole reason for a captive's existence is to protect the insureds' assets through careful claims management. According to Maglaras, "Regardless of what your business is, regardless of what services you provide or what product you produce, every claim in a captive, where that claim has merit, is an opportunity to improve your business, your bottom line, and your reputation."

"Just like a traditional insurance company, the captive needs to have consistency in how it handles claims and needs to be able to demonstrate that consistency," said Sheils. "The establishing of a Claims Handling Procedure is going to help

Claims may not be the most interesting part of self-insuring, but it is the most important part. The captive insurance sector continues to grow, even in a continuing soft liability market, and there is a reason for that. "Once you get into the habit of adjusting your own claims and learning from the causality of loss, you never go back," said Maglaras.

According to Sheils, "Having a deeper knowledge of the business and having aligned priorities allows the captive to actively manage each and every claim with the goals of improving efficiency, promoting the philosophy of the company and gaining maximum benefit for the company." ■

Karrie Hyatt is a freelance writer who has been involved in the captive industry for more than ten years. More information about her work can be found at: www.karriehyatt.com.